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| Termination payments  |
| TUC submission |

1. Introduction
2. The Treasury and HMRC are consulting on the [*Simplification of the Tax and National Insurance Treatment of Termination Payments*](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448275/Simplification_of_the_Tax_and_National_Insurance_Treatment_of_Termination_Payments.pdf). The government plans to end the distinction between contractual and non-contractual termination payments and a new exemption from income tax and NICs set at a lower level than the current £30,000 allowance. This document presents a TUC response.

About the TUC

1. The Trades Union Congress is the voice of Britain at work. We represent 52 unions with 5.8 million members; trades unionists work in every town and region of the country, in every occupation and industry. We are grateful for this opportunity to submit comments on the HMT/HMRC proposals and will mainly concentrate on redundancy pay, which is the termination payment union officers most commonly deal with.

Summary

1. This submission argues:
* Workers affected by redundancies are very interested in the treatment of their redundancy pay, which has both an emotional and a financial significance for them.
* The tax exemption of compensation payments is a humane measure for people at a difficult time and particularly important for those who may be about to face financial hardship.
* The consultation document does not indicate the levels at which the proposed new exemption would be set; there is no information about likely winners and losers and no distributional analysis of the likely effects. At present, all we know is that workers entitled to redundancy payments above the new maximum would be liable to pay more tax and NI Contributions. We are therefore unable to support this proposal.
* The TUC does not believe that an adequate case has been made for lowering the £30,000 threshold. Indeed, we believe that it should be raised to match its value in previous years.
* The TUC also supports important reforms of the statutory redundancy pay system, including raising the cap on weekly pay used to calculate maximum entitlements and abolishing the 20 year maximum. The TUC also believes that the right to statutory redundancy pay should not be limited to ‘employees’. This document also sets out proposals for improving workers’ entitlements in insolvencies.
* The consultation document is silent on the tax treatment of protective awards made under Section 189 of the Trade Union and Labour Relations Act. The TUC calls on the government for reassurance that these payments will not be made liable to tax and National Insurance Contributions.
* The consultation document fails to mention the tax treatment of outplacement counselling offered as part of a redundancy package and this submission calls on the government to maintain the current provision.
* This response asks the government to clear up some uncertainty arising from unclear wording in the consultation document about the tax treatment of employer payments towards pension arrangements.

Why unions think this is an important issue

1. The amount of redundancy pay awarded to workers is often determined by careful negotiations by managers and union representatives. Unions are keen to ensure the fair treatment of workers losing their jobs, especially through redundancy. At the same time, good employers wish show that, even though they have had to make their employees redundant, this is not a judgement on the intrinsic worth of the staff who are leaving the company.
2. Unions have always regarded redundancy pay as a means by which people who are returning to the labour market can pay for retraining and other career development measures needed to manage this insecure transition successfully. In addition to this wider economic justification, these payments have an emotional significance and a monetary value.
3. Employees facing redundancy will often regard this final payment as, to some degree, an evaluation of the work they have done for the employer. They have often contributed years of service and a fair redundancy payment is an acknowledgement of this. It confirms the truth of any statements the employer has made about being reluctant to make staff redundant.
4. Redundancy pay, can partly compensate workers for being forced into jobs with lower pay or worse conditions than those they have lost. A 2008 study of the 2005 closure of the MG Rover plant at Longbridge found that most of the 6,300 workers who lost their jobs found new jobs over the next three years and that most of these jobs were permanent. But only 28% said their new job was better than the one they had at MG Rover and two thirds had been forced to accept worse paid jobs, with average pay falling **£5,640** in real terms.[[1]](#endnote-1) (Note that this research covered the mid-2000s boom, we do not know what happened to these workers in the global crisis.)
5. Workers are well aware of the “scarring” effect of redundancy: that their next job is likely to pay significantly less and that if they cannot get another job they will probably have to rely on spectacularly ungenerous Jobseekeer's Allowance rates. Their last pay cheque thus assumes an added significance.

The government’s proposals

1. The government plans to end the distinction between contractual and non-contractual termination payments. In principle, all termination payments would be subject to income tax and NICs, but a new exemption would be created for people losing their jobs. The new exemption would be offered to people with more than two years’ service with their employer and then increase proportionately with the number of years of service up to a maximum amount, set at a lower level than the current £30,000 allowance.
2. The consultation document argues that termination payments are a very complex area of the tax system. When an employee leaves employment they will typically get a package including statutory and other redundancy compensation, notice pay and unpaid wages like holidays owing. Contractual entitlements like notice pay and unpaid wages are liable to tax and NIs but redundancy pay and other compensation are tax-free up to £30,000.
3. The government claim that this is confusing and plan to “simplify” matters by removing the distinction between contractual and non-contractual termination payments. This would mean that all payments made in connection with termination of employment would be earnings and subject to income tax and employer and employee NICs. The government does, however, plan to create a new exemption from income tax and NICs “because removing the exemption would have a significant cost impact for some people, especially those who receive smaller termination payments”. The consultation document asks for views on options for doing this.

The case for the tax exemption

1. Last year the Office of Tax Simplification published a final report[[2]](#endnote-2) on employee benefits. The TUC agrees with their clear and brief exposition of the case for the tax exemption:

*2.13 These original considerations remain relevant today. From a pure simplification basis, imposing tax in full on all termination payments is the simplest approach. However, it is likely to have a significant cost impact for some people, particularly those lower paid employees who may more often be the ones receiving smaller termination payments;* ***who are, after all, losing their job****.* (Emphasis added)

The uncertainties surrounding these proposals

1. Apart from the fact that the maximum would be lower than the current taxation threshold, we know very little about how this exemption would operate – what level of earnings would be exempted from tax and NICs for people with two years’ service and how much would it rise with each additional year of service? How much lower would the maximum be than the current threshold? The examples in the consultation document are calculated assuming a threshold of £6,000 after two years of service and then a further £1,000 for each additional year, but our understanding is that these numbers are purely for illustrative purposes and that we should not presuppose that these are the amounts that will eventually be set.
2. This lack of detail makes it impossible to assess who would win and who would lose from these plans. Workers entitled to more redundancy pay than the new maximum would be worse off under the new proposals. Those with contractual pay entitlements – especially to notice pay and holiday pay – would be better off. Some workers would both gain and lose but it is impossible at present to work out what their net position would be.
3. In principle the TUC recognises that the workers entitled to higher redundancy payments would tend to be higher-paid, while those with lower total entitlements but with some contractual pay would tend to be lower-paid. Unfortunately, there is no distributional analysis of the likely effect of the reforms, so it is impossible to judge whether the gains would outweigh the losses.
4. **At present, all we can be sure about is that some workers, who would otherwise be entitled to redundancy payments above the new maximum but below the current threshold, would now be worse off. Until there is more detail about the proposals, and a distributional analysis of their likely impact, we are unable to support them.**

Are these proposals needed?

1. This consultation is in response to the Office of Tax Simplification’s final [report](https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report) on employee benefits and expenses, which identified termination payments as a very complex area of the tax system. The consultation document claims that the government wants employees to be certain about their entitlements and to achieve “real simplification for businesses”.
2. The TUC is not convinced that the system is so complicated that a substantial reform is needed. Our experience is that the difference between contractual entitlements and compensation is easily understood. When workplace representatives have to negotiate redundancies their unions have successfully briefed them about this difference and have not reported that this is a significant problem.

The £30,000 threshold should be *raised*

1. The TUC has not been convinced of the case for these proposals. Indeed, we there are good reasons for maintaining that the threshold should be *raised*. It was set at £5,000 when introduced (by a Conservative government) in 1960 and has remained at £30,000 since 1988, when it was last increased (also by a Conservative government).
* If the threshold had maintained its 1960 value it would now stand at £102,851.
* If it had been inflation-linked since 1988 it would now be £71,852.[[3]](#endnote-3)

The inadequacy of statutory redundancy payments

1. These proposals will mainly affect the former employees of good companies, which provide redundancy payments above the statutory minimum and members of unions that have negotiated decent packages for their members. This is because, sadly, workers whose termination payments consist only of statutory redundancy pay will not be entitled to a great deal, as the maximum amount of statutory redundancy pay is just £14,250.
2. Statutory redundancy pay is calculated as follows:[[4]](#endnote-4)
	* half a week’s pay for each full year worked under the age of 22;
	* one week’s pay for each full year worked when aged 22 to 40;
	* one and half week’s pay for each full year worked when aged 41 or older.

Years worked over a maximum of 20 are not included in the calculation and weekly pay is calculated subject to a maximum level of £475.

1. The limit to weekly pay in this calculation was introduced in 1965, when it was set at £40 – more than twice the then average weekly wage of £19.60. It is now worth 96 per cent of average weekly earnings, which currently stand at £496 per week.[[5]](#endnote-5) If it had been increased in line with earnings it would now be £1,000. If it had been increased in line with inflation, it would now be over £700.[[6]](#endnote-6)
2. In 2012, 13 per cent of workers – more than one in eight – had been working with their current employer for more than 20 years, so the current system penalises a large number of workers for failing to change employer.[[7]](#endnote-7)
3. It is also worth noting that entitlement to statutory redundancy pay is limited to employees, thus excluding many workers for whom redundancy is just as much a disaster. The TUC is particularly concerned about the exclusion of workers on zero hours contracts, agency workers and workers forced into bogus self-employment.
4. **The TUC believes that the £475 cap on weekly pay should be substantially raised to bring it into line with average earnings. The 20 year maximum should be abolished. The TUC also believes that the right to statutory redundancy pay should not be limited to ‘employees’. All workers should be entitled to this right, including those on zero hours contracts, agency workers and those employed on self-employed arrangements who are economically dependent on one or a limited number of employers.**

Ability to recover payments from the Redundancy Payments Fund in insolvency situations

1. Alongside increases to statutory redundancy pay, the TUC also believes that steps should be taken to increase the financial security of individuals facing redundancy as a result of a business closure. The TUC believes that in the event of an employer’s insolvency, individuals should be able to recover in full all forms of remuneration owed to them by their employer. This includes all contractual and statutory entitlements. Such financial guarantees would not only ensure that employees received what they are legally owed. More importantly it would assist working people to meeting their household costs whilst they are out of work and to invest in training necessary to pursue alternative employment opportunities. To this end, the TUC believes that:
* The limits on the forms and amount of remuneration which employees can recover from the Redundancy Payments Office should be removed. Individuals should be able to recover all payments legally owed to them by the insolvent employer, including contractual holiday and sick pay, enhanced redundancy payments and unpaid employment tribunal awards.
* The limit on preferential debts in insolvency should be removed. The limit is currently £800 and has not increased since 1976.
* Trade unions are unable to recover employment fees from the Redundancy Payments Office following a successful application for a protective award. The TUC believes that ET fees should be waived in cases where claims are brought against insolvent employers.
* The individuals who are able to recover funds from the Redundancy Payments Office is currently limited to those who legally qualify as employees under employment law. As a result, many individuals on insecure contracts, including zero hours contract workers and agency workers and individuals who are employed on a self-employed basis, are not able to recover unpaid wages via the Redundancy Payments even though they were economically dependent on the employer who became insolvent. The TUC believes that individuals in all forms of employment should be able to apply to the Redundancy Payments Office to recover unpaid remuneration.

Missing items in the consultation

1. Under the current system, the following payments benefit from the £30,000 tax threshold:
* unfair dismissal awards,
* damages payments for wrongful dismissal,
* discrimination payments which compensate for financial loss and
* protective awards made under Section 189 of the Trade Union and Labour Relations (Consolidation) Act 1992.
1. The 2014 Office for Tax Simplification report listed these payments and said that the options were either to make specific provision or to “accept that the value of these payments to departing employees would be reduced by the tax that they would now have to pay on them.”
2. Under section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992, where an employer fails to consult the union on a redundancy affecting 20 or more employees the union can apply for a protective award for them. Section 189 says the compensation is a week's pay per week of the "protected period" (which is determined by a tribunal up to a maximum of 90 days).
3. The consultation document only asks about new exemptions for “Compensatory amounts for unfair/wrongful dismissal” and “compensatory amounts for loss of future earnings following discrimination”. The OTS report said “We would expect the consultation to consider these options and their implications”[[8]](#endnote-8) and plainly meant all of the bullet points above. The TUC calls for all these payments to continue to benefit from the £30,000 threshold. If the government plans to end this for awards under the Trade Union and Labour Relations or the Employment Rights Act 1996 it should explain why.
4. The OTS report also notes that, under section 310 of the Income Tax (Earnings and Pensions) Act 2003, outplacement counselling offered as part of a redundancy package and related travelling costs are exempt from tax. The consultation document does not mention this. Most workers facing redundancy are not offered this counselling, but it is a positive measure and it would be a shame if workers were penalised for accepting an offer of help in a difficult time. This may be an oversight and the TUC calls on the government to indicate its intentions in this matter.

Termination payments and pensions

1. Paragraph 4.37 of the consultation document says:

*The government will not be seeking to apply tax or NICs to any part of a termination payment that would normally be exempt from tax and NICs if it was paid as part of salary. For example payments into a registered pension scheme would not be taxed if they were made from salary so there would be no tax and NICs liability (up to any limits in the legislation) where these payments are made from termination payments.*

1. This wording may be open to misinterpretation and the TUC would welcome a reassurance that any proposals to change the tax treatment of termination payments will exempt employer payments towards pension arrangements in respect of employees whose employment is terminated. What is more, these payments should not count towards any exemption applied for the purposes of calculating income tax and national insurance.

References

1. *Life after Longbridge: Three Years on,* David Bailey, Caroline Chapain, Michelle Mahdon and Rebecca Fauth, Work Foundation, 2008, <http://www.theworkfoundation.com/DownloadPublication/Report/204_MG_Rover_130509.pdf> [↑](#endnote-ref-1)
2. *Review of employee benefits and expenses: second report,* Office of Tax Simplification, 2014, <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report> [↑](#endnote-ref-2)
3. Calculated using the ONS Composite Price Index 1800 – 2014 (table 50 of <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/june-2015/rft-cpi-june-2015.xls>) [↑](#endnote-ref-3)
4. Taken from the gov.uk pages on redundancy: <https://www.gov.uk/redundant-your-rights/redundancy-pay> [↑](#endnote-ref-4)
5. Calculated using *UK Labour Market*, ONS, September 2015, table 15, <http://www.ons.gov.uk/ons/dcp171778_414231.pdf> [↑](#endnote-ref-5)
6. Calculated using *Consumer Price Inflation*, ONS, September 2015, table 36, <http://www.ons.gov.uk/ons/dcp171778_419255.pdf> [↑](#endnote-ref-6)
7. This is the most recent ONS data available; <http://www.ons.gov.uk/ons/about-ons/business-transparency/ad-hoc-data/pre-june-2012/length-of-job-tenure-with-current-employer-2001-2011.xls> [↑](#endnote-ref-7)
8. Op cit, para 2.49. [↑](#endnote-ref-8)